

Tax Cuts and Jobs Act



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Course Development Resources

- The author gratefully acknowledges **RIA Checkpoint** for use of certain materials included in this presentation.
- Additional materials are adapted from various authoritative pronouncements of the IRS.
- The opinions expressed within, however, are solely the responsibility of the author.

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2

Advance Apology

- If you find an error in the materials....
- or ask a question I don't know the answer to...
- **I apologize in advance.**
- It isn't easy wrapping your arms around a 500 page law with holes in it you can drive a truck through.
- It will take us years to master this

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3

Advance Apology

- On Monday January 29, Annette Nellen, the AICPA Tax Executive Committee Chair sent an urgent letter to the IRS and Treasury calling on the IRS to issue immediate guidance in **39 (!)** areas affected by the new Act
 - At the Top of her list was the Section 199A 20% Deduction

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4

Trump Reform



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5

Tax Cuts and Jobs Act

- On Friday December 22 President Trump signed the Act



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6

“Tax Cuts and Jobs Act”

- The proposed act provides for @ **\$1.5 trillion** in cuts over 10 years...
- About \$150 Billion a year....

[7]

Tax Cuts and Jobs Act

- Three (3) major tax policy shifts:
 - 1) Reduce Corporate Tax Rates to 21%
 - 2) Shift from Worldwide taxation to a Territorial system
 - 3) Shift from depreciation to capital expensing

[8]

Tax Cuts and Jobs Act

- Three (3) major tax policy shifts
- Everything else is Secondary

[9]

Tax Cuts and Jobs Act

- In General the Conference Committee adopted the Senate approach
- It suspends certain tax provisions for 8 years from 2018-2025

[10]

Good News/Bad News

- With a couple exceptions, the law is not retroactively effective in 2017
- Generally effective for tax years beginning after December 31, 2017

[11]

Good News/Bad News

- Changes retroactively effective in 2017 include:
 - 7.5% AGI Medical expenses for all taxpayers (not just seniors)
 - Repealing substantiation of charitable deductions reported by the donee organization
 - **100% Bonus depreciation (new or used) placed in service after Sept. 27, 2017**
 - 2016 Disaster Provisions

[12]

Individual Taxes



Tax Cuts and Jobs Act

- The Act keeps 7 tax brackets – with changes - from 2018-2025
 - Ranging from 10% to 37%
 - A 2.6% cut in the highest tax rate

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14

Single Tax Brackets

If taxable income is:	Then income tax equals:
<i>Single Individuals</i>	
Not over \$9,525	10% of the taxable income
Over \$9,525 but not over \$38,700	\$952.50 plus 12% of the excess over \$9,525
Over \$38,700 but not over \$82,500	\$4,453.50 plus 22% of the excess over \$38,700
Over \$82,500 but not over \$157,500	\$14,089.50 plus 24% of the excess over \$82,500
Over \$157,500 but not over \$200,000	\$32,089.50 plus 32% of the excess over \$157,500
Over \$200,000 but not over \$500,000	\$45,689.50 plus 35% of the excess over \$200,000
Over \$500,000	\$150,689.50 plus 37% of the excess over \$500,000

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15

MFJ Tax Brackets

<i>Married Individuals Filing Joint Returns and Surviving Spouses</i>	
Not over \$19,050	10% of the taxable income
Over \$19,050 but not over \$77,400	\$1,905 plus 12% of the excess over \$19,050
Over \$77,400 but not over \$165,000	\$8,907 plus 22% of the excess over \$77,400
Over \$165,000 but not over \$315,000	\$28,179 plus 24% of the excess over \$165,000
Over \$315,000 but not over \$400,000	\$64,179 plus 32% of the excess over \$315,000
Over \$400,000 but not over \$600,000	\$91,379 plus 35% of the excess over \$400,000
Over \$600,000	\$161,379 plus 37% of the excess over \$600,000

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16

Tax Brackets

- **VIP:** Singles between \$157,000 and \$200,000 will pay 32% vs 28% now

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17

Tax Brackets

- **VIP:** You now hit 35% at \$200,000 single, \$400,000 MFJ
- vs. \$416,700 under current law for both Single and MFJ

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18

Estates and Trusts Tax Brackets

Estates and Trusts	
Not over \$2,550	10% of the taxable income
Over \$2,550 but not over \$9,150	\$255 plus 24% of the excess over \$2,550
Over \$9,150 but not over \$12,500	\$1,839 plus 35% of the excess over \$9,150
Over \$12,500	\$3,011.50 plus 37% of the excess over \$12,500

[19]

Tax Brackets

- “Kiddie Tax” brackets and filing points were adjusted, too

[20]

Good News:

- The 0%, 15% & 20% rates for LTCG and Qualified Dividends were retained
 - 0%
 - 15% starts at \$ 38,600/\$ 77,200
 - 20% starts at \$425,800/\$479,000

[21]

Standard Deduction

- The Act *almost* doubles the Standard Deduction to:
 - **\$24,000** Married Filing Joint
 - **\$12,000** Single
 - Singles with one qualifying child (HoH) get \$18,000
- **But not until 2018!**

[22]

Standard Deduction

- Personal and dependency exemptions are suspended for 8 years from 2018 to 2025
 - Not repealed

[23]

Eliminates all personal exemptions...

- Mom, Dad and two kids in 2018
- Under prior law:
 - \$13,000 Standard Deduction
 - Plus 4 exemptions at \$4,150 = \$16,600
 - Total = **\$ 29,600**
- Vs. **\$ 24,000** Standard deduction under the Framework.
 - a **\$5,600** Haircut!

[24]

Estate and Gift Taxes

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{ 25 }

Estate and Gift Taxes

- The Estate, GST and Gift Tax exemption is increased to \$10 million thru 2025
 - Adjusted for inflation
 - \$11.2 million in 2018

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{ 26 }

Estate and Gift Taxes

- Beware of disinheriting the spouse with a standard formula bequest....

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{ 27 }

Estate and Gift Taxes

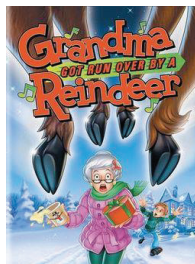
- The Estate and Gift Tax exemption Drops back to \$5 million in 2026 !
- So Christmas 2025 

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{ 28 }

Estate and Gift Taxes

- Christmas 2025...



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{ 29 }

Business Taxes



Corporate Taxes

- The Act drops the Corporate Tax Rate to flat **21%** permanently
- Effective for **2018 (!)**
 - The senate had put it off till 2019

[31]

Meals & Entertainment

- **Eliminates** most meals and entertainment expenses !

[32]

Meals & Entertainment

- **No deduction** would be allowed for:
 - Any entertainment, amusement or recreation activities;
 - Any membership dues relating for any club organized for business, pleasure, recreation or other social purposes; or
 - Any facilities used in connection with the above

[33]

Meals & Entertainment

- For 2018-2025 may still deduct **50%** of meals for the convenience of the employer
 - After 2025 they're 100% non-deductible

[34]

Meals & Entertainment

- May still deduct 50% of food and beverages when on work related travel

[35]

§199A Pass-Through Income



[36]

§199A Pass-Through Income

- The Act gives some Non-wage pass-through income a 20% deduction
- Its NOT permanent – just 2018-2025
- Gone in 2026

[37]

§199A Pass-Through Income

- The Act would give some Non-wage pass-through income a 20% deduction
- Not a 20% tax rate – a deduction
- Just like Section 199 9% deduction

[38]

§199A Pass-Through Income

- At 10% it reduces your rate by 2% to 8%
- At 12% it reduces your rate by 2.4% to 9.6%
- At 22% it reduces your rate by 4.4% to 17.6%
- At 24% it reduces your rate by 4.8% to 19.2%
- At 32% it reduces your rate by 6.4% to 25.6%
- At 35% it reduces your rate by 7% to 28%
- At 37% it reduces your rate by 7.4% to 29.6%

[39]

§199A Pass-Through Income

- The deduction is generally 20% of qualified business income from a partnership, S corporation or sole proprietorship
- Its not just for pass-throughs!

[40]

§199A Pass-Through Income

- “Qualified Business Income”
- **Net** amount of **qualified items** of income, gain, deduction and loss relating to any qualified trade or business of the taxpayer
 - Excludes REIT dividends, qualified cooperative dividends and publicly traded partnership income

[41]

§199A Pass-Through Income

- **Qualified items** must be effectively connected with the conduct of a trade or business within the United States
- And included or allowed in determining taxable income for the year

[42]

§199A Pass-Through Income

- If **Net** Qualified items is less than zero, that amount is carried over as a loss from a qualified trade or business in the succeeding tax year

[43]

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§199A Pass-Through Income

- The following investment items are excluded:
 - Short and long term capital gains and losses
 - Dividends, dividend equivalents and payments in lieu of dividends
 - Any interest income not properly allocable to a trade or business
 - Commodity and foreign currency gain or loss
 - Notional principal contracts
 - Annuities

[44]

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§199A Pass-Through Income

- Qualified Business Income does **not** include:
 - Reasonable compensation paid to the taxpayer for services rendered to the business
 - Any Section 707(c) guaranteed payments to partners for services rendered
 - Any Section 707(a) payments to a partner outside his partner capacity for services rendered to the business

[45]

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§199A Pass-Through Income

- Where business is conducted through a partnership or S Corporation part of its income may have to be treated as compensation
 - **Not** eligible for the 20% deduction!
- But if the business is a sole proprietorship or single member LLC **all** of the business income can be qualified business income and get the 20% deduction!

[46]

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§199A Pass-Through Income

- There are two limitations on the deduction that apply only when your taxable income exceeds a threshold amount
 - \$157,500 Single/\$315,000 MFJ
- W2 wage/depreciable asset limit
- Exclusion of specified services

[47]

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§199A Pass-Through Income

- Qualified Business Income 20% deduction
 - Limited to the greater of:
 - 50% of the taxpayer's W-2 wages paid; or
 - 25% of W-2 wages paid plus 2.5% of the unadjusted basis immediately after acquisition of all qualified depreciable property

[48]

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§199A Pass-Through Income

- W2 Wages are the total Section 6051(a)(3) and Section 6051(a)(8) elective deferrals paid to employees for the year properly allocable to qualified business income
- Wages must also be properly included in a return filed with the Social Security Administration within 60 days after the due date (including extensions) for the year

[49]

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§199A Pass-Through Income

- Qualified depreciable property ends on the date:
 - 10 years after the asset is first placed in service; or
 - The last day in the applicable recovery period

[50]

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§199A Pass-Through Income

- So you can count the unadjusted basis of 3, 5, 7 & 10 year MACRS assets for 10 years
 - Year placed in service + 9 following
- For 15, 20, 27.5 & 39 year assets you get to use their basis for the full MACRS life

[51]

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§199A Pass-Through Income

- Partners and S Shareholders are treated as having their allocable share of the W2 wages and depreciable assets of the business

[52]

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§199A Pass-Through Income

- Business owners with little or no W-2 wages or depreciable assets may still take the full 20% deduction if under \$157,500/\$315,000 taxable income

[53]

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§199A Pass-Through Income

- Higher income taxpayers over \$157,500/\$315,000 have a clear incentive to hire W-2 employees
 - Not 1099 contractors

[54]

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§199A Pass-Through Income

- You need to separate and determine the qualified business income and w-2 wages for each trade or business
- Problem for management company structures and common paymasters

55

§199A Pass-Through Income

- Income from services in the fields of health, law, ~~engineering, architecture~~, accounting, actuarial science, athletics, performing arts, consulting or any business where the principal asset is the reputation or skill of one or more of its employees, etc. (See Section 1202(e)(3)(A))
- Is not eligible for the 20% deduction!

56

§199A Pass-Through Income

- Also Income from financial services and brokerage services
 - Including investing and investment management, trading or dealing in securities, partnership interests or commodities
 - (See Sections 475(c)(2) and (e)(2))
- Is not eligible for the 20% deduction!

57

§199A Pass-Through Income

- Apparently doctors, dentists, lawyers and accountants (partners) are “The Rich” who should not get a tax break under the Act
- But rich Architects and Engineers are OK
 - Or they have a better lobbyist

58

§199A Pass-Through Income

- Income from excluded services may still take the 20% deduction if under \$157,500/\$315,000 taxable income
- So it should generally be OK as long as you aren't a Senior Partner or on the management committee

59

§199A Pass-Through Income

- Taxable income phaseout for excluded services:
 - Phaseout from \$157,500 to \$207,500
 - Lose 1% for every \$2,500 over
 - Phaseout from \$315,000 to \$415,000
 - Lose 1% for every \$5,000 over

60

§199A Pass-Through Income

- **Note:** \$157,500/\$315,000 is also where the 24% bracket ends and you jump to 32%

{ 61 }

§199A Pass-Through Income

- The 20% deduction is taken below the line
 - It reduces taxable income, not AGI
 - It is allowed to non-itemizers

{ 62 }

§199A Pass-Through Income

- It only applies for income tax purposes
 - It doesn't apply to SE tax

{ 63 }

§199A Pass-Through Income

- The IRS is directed to issue regulations...

{ 64 }

AICPA Letter

- On Monday January 29, Annette Nellen, the AICPA Tax Executive Committee Chair sent an urgent letter to the IRS and Treasury calling on the IRS to issue immediate guidance in **39 (!)** areas affected by the new Act
 - At the Top of her list was the §199A 20% Deduction

{ 65 }

AICPA Letter

- Specific §199A issues mentioned include:
 - The definition of excluded service businesses
 - How business losses are netted
 - Employee leasing
 - Can a management company be treated as an integral part of the operating business
 - Is real property rental income qualified
 - Unadjusted basis of assets held 1/1/2018
 - And much more!

{ 66 }

§199A Pass-Through Income

- Some may choose to convert from employee to independent contractor to take advantage of the 20% deduction
- But beware the loss of health insurance and other fringe benefits, different pension rules...

[67]

§199A Pass-Through Income

- Note: When claiming the §199A deduction the 20% substantial understatement penalty applies if the amount of the understatement is only 5% of the tax required to be shown on the return
- Not the normal 10% understatement

[68]

Reconsider Choice of Entity

- We appear to be returning to pre-TRA '86 environment where individual tax rates are significantly higher than corporate tax rates



[69]

Reconsider Choice of Entity

- You may be better off as a C corporation
- Even with double taxation



[70]

“Tax Cuts and Jobs Act”

- The top rate is now 37%
- And the ACA 3.8% NIIT is still in effect
- So a marginal rate of 40.8% for some taxpayers !

[71]

“Tax Cuts and Jobs Act”

- **Warning!** – the 35% bracket starts at \$200,000 single, \$400,000 MFJ
- vs. \$416,700 under current law for both Single and MFJ

[72]

Reconsider Choice of Entity

- **Active** pass-thru income pays 35% over \$200,000/\$400,000
 - 37% over \$500,000/\$600,000
- Some get the 20% deduction
- But not many service businesses

[73]

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Reconsider Choice of Entity

- **Makes that flat 21% rate for C Corporations look pretty good**
- Personal Service Corporations ?

[74]

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Reconsider Choice of Entity

- What happens when you pay Bonuses?
 - Ordinary Income 35% or 37%
 - Plus 2.9% Medicare over the wage base
 - Plus 0.9% Medicare on Wages and SE over \$200/250 AGI

[75]

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Reconsider Choice of Entity

- What happens when you pay dividends?
 - \$100,000 taxable income, less 21% = 79,000 available to pay dividends
 - 15% = 11,850 Total tax = \$32,850
 - 18.8% = 14,852 Total tax = \$35,852
 - 23.8% = 18,802 Total tax = \$39,802

[76]

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Reconsider Choice of Entity

- What happens when you pay dividends?
 - So total tax = @ 32.8%, 35.8% or 39.8%
 - And you've had the opportunity to defer the second round of tax

[77]

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Reconsider Choice of Entity

- Consider Section 1202 100% exclusion of gain on sale of Qualified Small Business Stock (QSBS)
- 100% exclusion for qualified stock issued after September 27, 2010



[78]

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{ 79 }